

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

76-5034

United States Court of Appeals
FOR THE SECOND CIRCUIT

In re

INTERSTATE STORES, INC. formerly known as INTERSTATE
DEPARTMENT STORES, INC., et al.,

Debtors-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF APPELLEES

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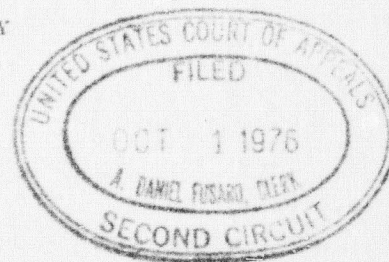


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Issues Presented

1. Does this Court have jurisdiction to hear the appeal under Section 24(a) of the Bankruptcy Act (11 U.S.C. §47). This issue is presented in a separate motion previously filed with the court and, therefore, will not be briefed herein.
2. Did the United States District Court for the Southern District of New York properly revoke a reference to and set aside an order of the Bankruptcy Judge upon the refusal of the Bankruptcy Judge to set down for trial the trustees' objections to the largest claim filed in the reorganization proceeding, a claim which accounts for over 50% of all unresolved claims, where uncontradicted evidence presented to the Bankruptcy Judge demonstrated that said claim must be adjudicated before any meaningful plan of reorganization can be formulated.

STATEMENT OF THE CASE

Preliminary Statement

Joseph P. Crowley and Herbert B. Siegel, Trustees in Reorganization of Interstate Stores, Inc., appealed to the District Court from an Order of The Honorable Edward J. Ryan, Bankruptcy Judge, dated and filed July 23, 1976 (A482-85*), which had denied with prejudice the Trustees' motion to have their objection to Claim No. 7273A of Esqro, Inc. in the amount of \$38,758,972 set down for trial on September 15, 1976, or as soon thereafter as the Court's calendar permitted. In refusing to schedule the trustees' objections to the claim for trial, the Bankruptcy Judge had effectively relinquished jurisdiction over the largest claim filed in this proceeding in favor of the California Superior Court where a tentative trial date of November 29, 1976 has been obtained.**

* References are to Joint Appendix.

** Contrary to statements made in Appellant's brief that the Bankruptcy Judge had directed that the Esqro claim be tried in the California State Court (Appellant's Brief, p. 25) and that the "District Court reinstated the stay of the California Lawsuit" (Appellant's Brief, p. 6). The District Court's order neither reinstated nor refused to vacate the stay. The District Court's order merely revoked its reference of the reorganization proceeding to the Bankruptcy Judge with respect to the Esqro claim and directed that the trial of the Trustees' objection to claim be held on October 18, 1976. This is the basis for the Trustees' motion to dismiss the appeal. Indeed Appellant's contention that Judge Cannella reinstated the stay is belied by Appellant's service of discovery requests in the California Proceeding subsequent to the entry of the September 1, 1975 order.

It was the Trustees' position on its appeal to the District Court that the Bankruptcy Judge erred in so relinquishing jurisdiction over a claim upon which the success of the debtors' attempt to reorganize might well depend and that any delay, even to November 29, 1976, of the trial of the Esqro claim would seriously prejudice the estate in that it would effectively preclude the formulation of a plan of reorganization until that claim is determined in a jury trial, involving many issues not involved in the claim and which California counsel had estimated would take five to eight weeks to complete.*

The Esqro claim is no ordinary claim. It accounts for over 50% of all unresolved claims. (A 143-44) The speed with which the claim is adjudicated will control whether this entire proceeding will come to an expeditious conclusion. The manner in which the claim is adjudicated will control the very nature of any plan which might be formulated. Yet, the Bankruptcy Judge relinquished jurisdiction over the claim in favor of the

* Appellant makes much of the fact that California counsel estimated that a jury trial of the California proceeding would take from 5-8 weeks. This of course militates in favor of a New York trial in that the Trustees' New York counsel has estimated that the trial of the Trustees' objection to the Esqro claim will take at most two weeks and may be completed in one week. (A 397) The reason for this is that if the trial is conducted in the Bankruptcy Court, the vast majority of the Trustees' evidence will be in the form of either documents (whose authenticity is not disputed) or depositions conducted in the course of pretrial discovery. Since this matter will be tried to the Court, the presentation of such evidence will take very little actual trial time. (A 537)

California State Court thus, in effect, placing in the hands of said Court control of further proceedings herein. In doing so, the Bankruptcy Judge, apparently for the sake of expedience in that he did not feel that the state of his calendar permitted a trial of the Trustees' objection to the claim (A 468-71, A 477-79, A 503), ignored the uncontroverted evidence of prejudice to the estate. Indeed, despite such evidence, the Bankruptcy Judge later entered a "finding" that there would be no prejudice or harm to the estate. (A 458)

The Esqro-White
Front Relationship

Involved in this claim are various subsidiaries of Interstate Stores, Inc., which operated a chain of department stores known as White Front Discount Department Stores in California and the Pacific Northwest. (A 2-3) From approximately 1956 through 1972, Esqro was a licensee operating certain departments in the various White Front Stores, first only the camera and jewelry departments and from approximately 1963, the liquor departments. (Doc. Nos. 1 and 2*) In December of 1970 Esqro and White Front entered into a modification of their master license agreement to provide for the operation by Esqro of so-called Residential Interior Departments. (Doc. No. 13) This particular modification, dated December 1, 1970, forms the basis for the \$38,758,972 claim filed by Esqro in this proceeding. (A 2-8)

* References to "Doc. " are to various documents which were received in evidence by the Bankruptcy Judge (A43, A203) and, although part of the Record on Appeal, were not included in the Joint Appendix because there is no dispute with respect to the facts recited herein concerning those documents.

It is undisputed that during the period of approximately one year in which it operated the Residential Interior Departments in the White Front Stores, Esgro never made a profit by reason of the operation of said departments. (A 188-89) Yet, of Esgro's \$38,000,000 claim, over \$24,000,000 is claimed as lost profits on the Residential Interior Departments.* (A 188) Another \$5,000,000 is claimed as punitive damages. (A 188)**

The Closing of White
Front Stores In Late
1972 and Early 1973

In December of 1972, Interstate decided to close 21 of the 33 White Front Stores because of the losses being incurred in connection with the operation of those stores. Even before this announcement was made, however, White Front had terminated Esgro's licenses because of substantial defaults by Esgro under

* Indeed, discovery thus far conducted has shown that Esgro incurred an operating loss in excess of \$2,000,000 while it operated the Residential Interior Departments and that its calculation of lost profits is based upon what it had projected its sales would be in 1974 rather than its actual sales record. Thus, Esgro took projected annual sales of over \$16,000,000, although its actual sales never reached even \$4,000,000 annually, and, after adding a growth factor, calculated projected lost profits of \$24,000,000 over the next 15 years.

** Approximately \$3,200,000 of the remainder of the claim is attributable to lost projected profits of Esgro on a certain agreement pursuant to which White Front Stores agreed to purchase certain plumbing and electrical supplies from Esgro and approximately \$2,300,000 is attributable to the operating loss incurred by Esgro in connection with its operation of the Residential Interior Departments. The remainder of the claim, approximately \$4,000,000, is attributable to the alleged fixture and inventory losses incurred when Esgro closed the Residential Interior Departments in late 1972 and early 1973.

its agreement with White Front (Ex. U to Doc. 21). These defaults included the failure to pay over \$700,000 due White Front as of May 25, 1972 as minimum annual compensation, the failure for two months to pay the percentage compensation provided for in the license agreements (over \$30,000) and the failure to reimburse White Front for substantial amounts of money spent by it on Esqro's behalf for advertising and other miscellaneous items (approximately \$50,000). (Ex. U to Doc. 21)

The California Proceeding

White Front's claim against Esqro resulted in the filing in early 1973 of an action by White Front against Esqro in the California Superior Court (the "California Proceeding") seeking to recover a total of \$879,121.52. (A 46, Doc. 21) Appellant for some unexplained reason places great importance upon the fact that White Front's complaint in the California Proceedings contains 208 causes of action. An examination of the complaint (Doc. 21) shows that it is anything but complicated, seeking merely to recover amounts due under the license agreement. The 208 causes of action were necessitated by the fact that claims were separately stated with respect to each of the 33 stores in which Esqro operated Residential Interior Departments and each of the 30 stores in which it operated liquor departments and, as to each department, claims were asserted on three and sometimes four different theories. The uncompli-

cated nature of the issues presented by the complaint are evidenced by the Trustees' California counsel's testimony that he didn't think it would take more than one day to put in evidence on the allegations contained in these 208 causes of action. (A225)

In March of 1973, Esqro filed a petition under Chapter XI of the Bankruptcy Act.* In July of 1973, Esqro served an answer to the complaint in the California Proceeding and also served a cross-complaint in that proceeding seeking to recover \$30,000,000 from White Front for fraud and breach of contract plus \$5,000,000 in punitive damages. (Doc. 23) Although discovery proceedings were initiated shortly after the cross-complaint was filed, no discovery was conducted and the California Proceeding remained dormant until after the May 21, 1976 hearing held herein before the Bankruptcy Judge (A 132-35, A 195-96).

Throughout, the Appellant has argued that the entire California proceeding should be decided in one forum. For example, at page 23 of its brief Appellant argues that "it is only through the prosecution of the California Lawsuit that the complex and multifaceted litigation between the parties can be completely

* White Front filed a claim for over \$1,400,000 in Esqro's Chapter XI proceeding (Doc 25). This amount included additional minimum compensation and additional percentage compensation and other miscellaneous items which had become due following the filing of the complaint in the California Proceeding and also took into account various offsetting items claimed by Esqro against White Front.

resolved." It is clear that if anything in the California Proceeding is "complex and multifaceted" - and it is the Trustees position that there is nothing - it is Esqro's cross-complaint which is the portion of the California Proceeding which is duplicated by Esqro's Claim herein which is scheduled to be adjudicated on October 18. Of course, any resolution of the claim will be binding on the parties* to the California proceedings and will be dispositive of both Esqro's cross-complaint as well as the affirmative defense based upon the cross-complaint.

For almost three years Esqro did not pursue what it would have the Court believe is a highly meritorious \$38,000,000 claim.** Unlike the claimants involved in both the cases discussed at pages

* Reference has also been made to the existence of additional parties in the California Action. However, the additional party, Triumph Sales, Inc., is a subsidiary of Esqro which operated the liquor department in the White Front Stores pursuant to an agreement that dated back to 1963 (Doc. 2) and which were in the process of being closed in late 1972 (Doc. 26). The allegations of the cross-complaint (Doc. 23) are concerned only with the Residential Interior Departments, specifically the circumstances surrounding the negotiation of the 1970 agreement relating to those departments and the subsequent closing of the White Front Stores in 1972.

** Some indication of the spurious nature of Esqro's claim can be gleaned by referring to a so-called probable cause hearing held by the California Bankruptcy Judge in Esqro's Chapter XI proceeding. The purpose of this hearing was to set the amount of deposit required to be made by Esqro in respect of White Front's claim for approximately \$1,400,000. After holding a hearing, the California Bankruptcy Judge balanced Esqro's \$38,000,000 claim against White Front's \$1,400,000 claim and came out with a net in White Front's favor of \$500,000, requiring a deposit of \$50,000. (A25-28)

26-32, infra, as well as those discussed in Appellant's brief, no attempt was made by Esqro to have the stay of the California proceedings vacated - until, of course, the Trustees pressed for adjudication of the claim early this year - so as to permit it to prosecute its \$38,000,000 claim, although one would expect that a resolution favorable to Esqro would have materially improved Esqro's position in its own Chapter XI proceeding. This, we respectfully suggest, demonstrates that the claim was asserted in the California Proceeding purely as a defensive measure to prevent the adjudication of White Front's rather straight-forward claim for rent and money due on an open account. This tactic by Esqro, coupled with the prospect of an ultimate recovery of far less than any judgment obtained by reason of Esqro's Chapter XI proceedings, resulted in White Front not pressing its claim. And, it is still not necessary for the formulation of a plan for the Trustees to press their claim against Esqro in that, even if completely successful, it would result at most in an initial payment of 10% in view of Esqro's recently approved plan of arrangement, a 30% plan calling for an initial payment of 10%. The Trustees, however, were, in effect forced by the Bankruptcy Judge to press the claim at this time.

The Filing of Claim No. 7273A

In August of 1974, Claim No. 7273A was filed by Esqro, Inc. in this proceeding. (A 2) The claim alleges that prior to the time the Residential Interior Department agreement was executed in December 1970 White Front had determined to either

sell or close all or substantially all of the White Front Stores and failed to disclose this intention to Esqro. (A 4) In this regard, it should be noted that no White Front stores were closed until late 1972, almost two years after the December 1970 agreement (A 32, A 48) and that some of the White Front stores remained opened until after this proceeding was instituted in May of 1974. The claim also alleges that misrepresentations were made to Esqro by White Front with respect to the continued operation of the White Front Stores and that Esqro in relying on said representations was damaged in the amount of \$33,758,972, which amount, along with \$5,000,000 in punitive damages, is sought. (A5-7)

The Trustees' Application
to Expunge Claim No. 7273A

On April 9, 1976, an application seeking to expunge Claim No. 7273A was served and filed. (A9-14) That application was returnable on June 13, 1976. (A 9) Concurrent with the service of that application, various discovery proceedings, including the service of a set of interrogatories, a deposition notice and a notice to admit, were instituted by the Trustees. (A 337) The deposition of Esqro by its President, Francis J. Esqro, was noticed for May 24, 1976. (A 337)

Toward the end of April, Messrs. Weil Gotshal & Manges acting for Irving Sulmeyer, the Receiver for the Chapter XI Estate of Esqro, requested an adjournment of the various discovery proceedings. (A 338) This request was agreed to upon

the condition that no further adjournments would be requested.
(A 338) This condition was at first accepted by Messrs. Weil
Gotshal & Manqes but then later rejected.(A 338)

Esgro's Complaint
Under Rule 10-601

On May 11, 1976, over one month after the trustees' application was served, Esgro, through its Receiver, served a summons and complaint under Chapter X, Rule 10-601*, for a modification of this Court's stay of suits as contained in its June 13, 1974 Order.(A 15-24) The complaint sought judgment (a) modifying the stay so as to permit Esgro to proceed with its cross-complaint in the California Proceedings, (b) dismissing the Trustees' objection to the Esgro claim, and (c) enjoining the Trustees from commencing or continuing with pretrial discovery before this Court. (A 24) At the same time, a temporary restraining order, which would have stayed pre-trial discovery previously commenced by the Trustees, was

* Appellant purports to take this appeal in connection with the adversary proceeding commenced by the filing of this summons and complaint although the trustees' application to the Bankruptcy Judge for an immediate trial was not made in the adversary proceeding (A 389) and neither papers submitted by Esgro in opposition to that application, (A 399, A 409), the July 23, 1976 order of the Bankruptcy Judge (which was prepared by Appellant's attorneys) (A 488), the papers submitted in connection with the Trustees' appeal from that order (A 487, A 489) nor Judge Cannella's September 1, 1976 (A 503) order contained the caption of the adversary proceeding. Indeed there would appear to be some question as to whether Irving Sulmeyer, Esgro's Chapter XI receiver has any standing whatever in this matter in view of the finalization of Esgro's Plan of Arrangement this past June.

presented to Bankruptcy Judge Ryan for signature.(A 339)
At a hearing held on May 11, 1976, Judge Ryan declined to enter such an order but directed that the trial of Esqro's complaint be heard on May 21, 1976.(A 339)

On May 21, 1976, the trial of Esqro's complaint commenced.(A 41) Esqro presented evidence through its California counsel, Arthur Sherwood of Gibson Dunn & Crutcher, to the effect that a trial of the California Proceeding could be had in the California Superior Court within approximately eight months provided the California Court granted a motion for an order advancing the trial date.(A129) The Trustees, on the other hand, presented evidence, which was uncontradicted, demonstrating that it was necessary to obtain an adjudication of Esqro's Claim No. 7273A before any feasible plan of reorganization could be formulated* and that the pendency of the Esqro claim was the principal impediment to the formulation of such a plan.(A142-51, A154-56)

It was further demonstrated during the course of the May 21, 1976 hearing that the Esqro claim was by far the largest claim filed in the proceeding. (A 149) Of the approxi-

* That the formulation of the plan of reorganization in the near future is a real possibility, assuming that the Esqro claim is resolved, is apparent from the fact that the debtors are now operating at a profitable level (earnings for the fiscal year ending February 1, 1976 having approximated \$19.45 million and for the prior fiscal year \$13 million [A 167-68]) and that available cash totals \$56-57 million. (A 165)

mately \$302,000,000 in claims that had been filed, orders expunging or reducing claims aggregating approximately \$80,000,000 had been obtained leaving a balance of approximately \$222,000,000.

(A143-44) In addition, it was estimated by Professor Joseph A. Crowley, one of the Trustees, that approximately \$10,000,000 in claims represent real estate claims which will be disposed of in connection with the plan of reorganization, since they are primarily claims by mortgagees on continuing store operations. (A 143-44)

Other than the Esgro claim, it was estimated by Professor Crowley at the May 21 trial that the final allowed claims should approximate \$150,000,000. (A 144) Therefore, the Esgro claim of almost \$39,000,000 represents over 60% of the remaining \$62,000,000 of disputed claims.

It was also demonstrated at the May 21, 1976 trial, without any contradiction whatever, that the Esgro claim must be determined before any realistic plan of reorganization could be formulated and presented to the Court. (A 150-51) It was shown that the first step in formulating a plan is to determine whether the estate is solvent, which involves an evaluation of the Company. (A 145) Of course, a determination as to whether an estate is solvent is required by Sections 179 and 216 of the Bankruptcy Act and this, in turn, determines whether the shareholders have the right to vote and participate in the reorganization. (A 145) Professor Crowley testified that, based upon preliminary evaluations of the debtors, the amount of the Esgro

claim represents the difference between a finding of solvency and insolvency. (A 145-48)

Furthermore, it was demonstrated that a \$39,000,000 claim, which, if not resolved, would have to be paid in one form or another, will substantially affect the capital structure of the reorganized debtor and the value of any securities distributed in connection with the plan. (A150-51, A171-74)

A further consideration pointed out by Professor Crowley at the May 21, 1976 trial was that, if the estate is solvent, creditors are entitled to accrued post-petition interest which has been accruing at a rate (based upon an annual rate of "something over prime") of almost \$1,000,000 a month. (A 152-53) Therefore, any delay in formulating a plan is seriously prejudicing the estate.*

Following the trial of the adversary proceeding, Judge Ryan entered an Order on May 26, 1976 which modified the stay of suits contained in this Court's June 13, 1974 Order to the extent of directing the parties to make an appropriate application to the California Superior Court, seeking an order advancing a trial date so as to obtain the earliest possible trial of the California Proceeding and directing that discovery

* On cross-examination, Esqro's counsel attempted to minimize this evidence by demonstrating that Interstate had available cash of approximately \$56-\$57 million that is presently earning interest. (A 165) However, even applying a liberal rate, the interest on this amount would come to only approximately \$300,000 per month, leaving a net interest owed by the estate of approximately \$700,000 per month.

and pretrial proceedings both in this action and in the California Proceeding be conducted and completed on an expedited basis.(A 323) The Order further provided that the parties were to advise the Court on or before July 8, 1976 as to the progress of discovery proceedings and the result of their application to the California Superior Court.(A 323) Otherwise, the relief requested in the Rule 10-601 complaint was denied in all respects.(A 324) It is important to note that the May 26 Order was interlocutory in nature in that it modified the stay only to a limited extent but did not either direct or permit the parties to proceed to trial in the California Proceeding.* Indeed it left open the place of trial and provided that all discovery, whether taken pursuant to the California Proceeding or this proceeding, could be used in either proceeding.(A 323)

No appeal was taken by either party from the May 26 Order.

Events Leading Up To
The June 16, 1976 Order

Following the entry of the May 26, 1976 Order, the Trustees attempted to proceed with the deposition of Esqro by its President, Francis J. Esqro, on the agreed upon adjourned

* Esqro has insisted that the May 26 order directed that its claim be tried in California as part of the California Proceeding. Of course, if this was the case, there would have been no need for the parties to report back to Judge Ryan on July 8 as to the results of the application to the California Court and the progress of discovery.

date, June 2, 1976.(A 340) However, Esqro's California counsel, after first agreeing to at least begin the Esqro deposition in early July, took the position that Mr. Esqro was busy attending to other matters, including the finalization of Esqro's Chapter XI plan of arrangement, and would not be available for a deposition until the end of July.*(A 340-41) This precipitated a motion by the the Trustees to strike Esqro's claim for its failure and refusal to appear for the previously noticed deposition.(A 335-36) This motion was denied without prejudice by order dated June 16, 1976.(A 387-88) In addition, rather than granting the Trustees some form of relief in view of Esqro's failure and refusal to appear for its deposition, the June 16 order directed, sua sponte, that all further discovery proceedings on the Trustees' objection to Esqro's claim "be conducted under the auspices and control of the California Court." (A 388)

The Application to
the California Court

Meanwhile, in accordance with the May 26, 1976 Order, California counsel for the Trustees applied to the California Superior Court for an order advancing the trial date of the California Proceeding.(A 395) On the return date of the motion

* Mr. Esqro's busy calendar was never called to Judge Ryan's attention during the course of the May 21 hearing. Rather, Judge Ryan was assured by Esqro's counsel that Esqro was prepared to proceed expeditiously with discovery. (A 206)

a trial date of November 29, 1976 was set.(A 395)* However, as the record demonstrates, this is not a firm trial date and, based upon past experience of California counsel, the estimated five to eight week jury trial in the California Proceeding might well be delayed for an additional three or four months after November 29, 1976.(A 212-214, A 395-97, A 418-19) The reason for this is that it has been the experience in the California Superior Court in the recent past for all cases called for trial for the first time to be adjourned in a wholesale fashion.(A 213) According to California counsel for the Trustees, this occurred this past spring as well as last fall. (A 213, A 418) It is important to note that nowhere does Esqro's California counsel deny or otherwise dispute this fact.

* Esqro makes much of the fact that this date was allegedly agreed upon by the Trustees' California counsel.(Appellant's Brief, p.14, 20) Indeed, for some reason, this alleged agreement is one of the "findings" recited in the July 23 order.(A 484) The affidavits submitted by California counsel, Mr. Sherwood for Esqro (A 409-12) and Mr. Holtzman for the Trustees (416-21), appear to conflict to some extent as to the earliest possible date upon which a trial could have been obtained in California. However, Mr. Sherwood admits in his affidavit that he "would not anticipate that all of the necessary discovery could be completed much in advance, if at all, of late October, 1976" (A 412) and that he had a trial of another matter scheduled "to commence on November 1, 1976".(A 410-11) Mr. Holtzman, on the other hand, clearly states in his affidavit that his trial calendar could certainly have accommodated a trial in the latter part of September (which he says was never offered).(A 420) Therefore, the fixing of a trial date in late November was certainly not attributable to Mr. Holtzman's other engagements as Mr. Sherwood would have had the Court believe.

Events Leading Up
to the Entry of the
July 23, 1976 Order

Until the order appealed from was entered, the stay of suits had been modified only to the extent of directing the parties to apply to the California Superior Court for the earliest possible trial date and permitting parties to proceed with discovery in the California Proceeding concurrently with the discovery previously commenced in this proceeding.*(A 322-23) When it became apparent that the California Proceeding could not be tried until November 29, 1976 at the very earliest and that it was quite possible that said trial would not commence until a considerably later date, a further application was made to Judge Pyan for an order setting down the trial of the Trustees' application to expunge Esoro's Claim No. 7372A, which had in effect been adjourned sine die by the Bankruptcy Judge, for September 15, 1976, or as soon thereafter as the Court's calendar permitted. (A 389-90) On July 23 Judge Pyan entered an order (A 482-85) which denied the application "in all respects, with prejudice". (A485) The July 23 order also purported to make a number of findings which not only had no support whatever in the record, but also were, in fact, directly contrary to uncontroverted evidence. Thus, in addition to denying the Trustees' application for a September 15, 1976 trial date with prejudice, said Order purported to find that:

* As noted, Judge Ryan, in his June 16 order, washed his hands of all discovery disputes that might arise, directing that all discovery be conducted "under the auspices and control of the California Court."

"8. No prejudice, harm or disability is incurred by the reorganization trustees or the reorganization cases by modification of the automatic stay under Chapter X Rule 10-601 so as to allow the prosecution and trial of the California action and

"9. The prosecution and trial of the California action as authorized by the court is in the interest of justice and convenience of the parties and potential witnesses."
(A 485; Emphasis added)

It is obvious from a reading of the transcript of the July 20, 1976 hearing that the primary factor considered by Judge Ryan was not the prejudice that would inure to the estate if the trustees application to have their objection to the Esqro claim tried was denied but, rather, the condition of his own calendar and his conclusion that he just did not have the time to try this all important claim. Thus, during the course of the July 20, 1976 hearing, Judge Ryan commented:

"THE COURT: I have set aside four week's vacation this year and that is the last two of August, and I'm now in the second of my vacation and I have tomorrow and I have Thursday. This is the first week of my vacation. All this should be on the record. I now have a current caseload of approximately 1,000 cases. Only 15 percent of them are non-consumer cases, they are Chapters X or XI. I have got R.Hoe, I have got Beck Industries now, I have a raft of SIPC cases. Each of those cases generates sub-cases in the sense of controverted proceedings. We are now setting down matters in one of the SIPC cases -- well, I'm opening October 13th, Havener Securities, a SIPC case.

"In Mangel's Stores, one of the major Chapter XI's, they have been taking day after day after day as they are open in my book. They go into October 30th.

"Now, even assuming that your optimistic prognosis is correct that this case will only take two weeks, that is a factor to be considered.

"MR. SHELTON: I agree, your Honor. I agree. I join in the problem because I think it is a terrible burden on you.

"THE COURT: I'm not complaining. I am under no contract. I can quit any time I want. I don't want this to sound like a pity pitch. But I want the record of these proceedings to be abundantly clear that what the parties are talking about at the present time is which forum can most expeditiously try this case. I don't have any brief on it. I don't know whether you have a brief prepared. I don't know whether Mr. Zirinsky does. There are any number of cases with respect to how happily the Bankruptcy Court's calendar can be adapted for the trial of lengthy cases. This is one case out of a thousand that I have, and if you want to take at least two weeks of calendar time, I just don't know where I am going to be able to handle the odds and ends of minutiae that come up on a daily basis with respect to all of the other cases.

"MR. SHELTON: Your Honor, there is no one who appreciates that problem more than I do, and I know it because I have been here that often and I have seen what happens to your Honor, and no one in this courtroom who has been around thinks any differently.

"THE COURT: Then I am at a loss to understand how you can say that it can be reached for a full, at least two-week trial earlier than it can be reached in California."
(A 468-70)

A little later, the Court went on to say:

"THE COURT: Let me ask you this: In Interstate, how many staves have been vacated to permit the trial of litigation in plenary suits, approximately? Since we are talking for the record, let's make a record here to the extent you will be done at least partially. I don't want the record left with the flavor that it is unusual to permit plenary suits to continue because I can simply state for the record it has been my experience over the last 13 years that in both Chapters X and XI, when there is a large litigation, protracted, complicated litigation, it's tried in courts of plenary jurisdiction. It's simply virtually impossible for the Bankruptcy Court to set aside such large blocks of time to handle particular cases in particular reorganizations. We just do not have that many days, even in a full 365-day year." (A 477)

* * *

"Most of the objections to claims tried in this Bankruptcy Court consume approximately a half-day. It's relatively infrequent that we have a full, 1-day trial, or even a two-day trial such as I have outlined for Thursday and Friday of this week. (A 478-79)

"MR. SHELTON: I agree, your Honor.

"THE COURT: But there are just so many days that we have available to ourselves."

Judge Cannella's September 1,
1976 Decision and Order

Since the July 23 order of Judge Ryan placed the trial of the Trustees' objection to the Esagro claim in a permanent state of limbo, and appeal was taken to Judge Cannella from that order.

In an opinion and order dated September 1, 1976, (A 503-5) Judge Cannella set aside the July 23 order, exercised his

right to vacate his prior reference of the reorganization proceeding to the Bankruptcy Judge with respect to the Esqro claim, and directed the parties to proceed to trial before him on October 18, 1976. (A 503-4) After recognizing that the "effect" of the Bankruptcy Judges refusal to schedule a trial of the Trustees' objection to the Esqro claim was to permit it to be tried in California and that the Bankruptcy Judge "based its decision primarily on the presently congested condition of its own calendar", Judge Canella concluded that "[e]ven a minor delay at this juncture would place an undue burden on these reorganization proceedings" and that the Bankruptcy Court abused its discretion in refusing to schedule an immediate trial. (A 504)

POINT I

THIS COURT DOES NOT HAVE JURISDICTION
TO HEAR THE APPEAL IN THAT THE SEPTEMBER 1,
1976 ORDER IS NOT APPEALABLE UNDER SECTION
24(a) OF THE BANKRUPTCY ACT (11 U.S.C. §47)

At the time Bankruptcy Judge Ryan entered the July 23, 1976 order, the only matter before him was the Trustees' application to have their objection to the Esgro claim set down for an immediate trial. Although Esgro had sought in its Rule 10-601 complaint to have the Trustees' objection to the claim dismissed (A 24), Judge Ryan had, in his May 26, 1976 order, refused to do this (A 334) and, indeed, that order only modified the stay to a very limited extent. As noted, no appeal was taken by either party from the May 26 order.

The September 1, 1976 order did not at all affect the modification that had been made to the stay in the May 26 order. It merely recognized that the Bankruptcy Judge did not have time to try the Trustees' objection to the Esgro claim, and, in view of the need for a speedy adjudication of this matter, directed that it be tried before the District Court. In order to accomplish this Judge Cannella revoked the reference of the reorganization proceeding to the Bankruptcy Judge as it related to the Esgro claim.

In view of the fact that the September 1, 1976 order was clearly interlocutory in nature - relating merely to the

regulation by the District Court of its own calendar - and did not dispose of the rights of any party, the Trustees have previously moved to dismiss the appeal upon the ground that the September 1 order is not appealable under Section 24(a) of the Bankruptcy Act (11 U.S.C. §47) and this Court, therefore, does not have jurisdiction to hear the appeal. For a complete discussion of the Trustees' contentions in this regard, the Court is respectfully referred to the Memorandum of Law submitted on behalf of the Trustees in connection with that motion, a copy of which is appended hereto.

POINT II

THE DISTRICT COURT PROFFERTY SET ASIDE THE BANKRUPTCY JUDGE'S JULY 23, 1976 ORDER WHICH REFUSED TO SET A TRIAL DATE FOR THE TRUSTEES' OBJECTION TO THE ESGRO CLAIM

Bankruptcy Judge Ryan's July 23, 1976 order contained a single decretal paragraph which merely "denied in all respects with prejudice" the Trustees' application for an immediate trial of their objection to the Esgro claim. However, that order also contained a number of purported "findings"* which are not at all supported by, and, indeed, are contrary to the evidence.

The September 1, 1970 memorandum and order recited that "[t]he effect of this denial [of an immediate trial on the objection to Esgro's claim] is to allow the Esgro claim to proceed to trial before the Superior Court of the State of California" (A 503; emphasis added). Even if this is interpreted as a refusal on the part of the District Court to vacate the stay or a reinstatement of the stay**, we respectfully suggest that the authorities discussed below demonstrate beyond question that the District Court's decision was proper in all respects.

* The July 23, 1976 order, including the "findings", was prepared by Esgro's attorneys and presented to Judge Ryan for signature. Judge Ryan adopted the the proposed finding in toto, a practice which has been repeatedly disapproved by this Court. See International Controls Corp. v. Vesco 490 F. 2d 1334, 1341 (2d Cir. 1974), cert. den. 417 U.S. 932 (1974).

** As noted above the Bankruptcy Judge never vacated the stay so as to permit a trial of the Esgro claim in the California proceedings and, therefore, there was no need for the District Court to reinstate the stay.

Under Section 111 of Chapter X of the Bankruptcy Act (11 U.S.C. § 511), the Bankruptcy Court has "exclusive jurisdiction of the debtor and its property, wherever located." This exclusive jurisdiction is not ordinarily surrendered except under exceptional circumstances. Manqus v. Miller, 317 U.S. 178, 186 (1942); In The Matter of Muskegon Motor Specialties Company, 313 F. 2d 841 (6th Cir. 1963), cert. den. 375 U.S. 832(1963).

We respectfully suggest that the facts of this case did not present "exceptional circumstances" that would justify the relinquishment by the Bankruptcy Judge of jurisdiction over what is by far the largest claim in this proceeding and the only apparent obstacle to the formulation of a plan of reorganization.

The cases dealing with the lifting or modification of a stay of suits in either a Chapter X or Chapter XI proceeding make it clear that the single most important factor to be considered in deciding whether or not a bankruptcy court should defer to a state court for a determination of matters already before it is the effect such action would have on the estate balanced against any prejudice to the claimant.* This principle was enumerated

* Although there was some discussion before Judge Ryan as to who had the burden of proof on an application to lift or modify a stay of suits, we respectfully suggest that such a discussion is academic at this point in view of the present state of the record where the prejudice to the estate was shown by uncontradicted evidence and - notwithstanding the statement made at page 19 of Appellant's Brief that "Esqro sustained its burden of establishing good reason for the California Lawsuit to proceed" - no prejudice whatever was demonstrated by Esqro. However, it is implicit from the requirement of Rule 10-601(c) that a "party seeking continuation of a stay against lien enforcement shall show that he is entitled there to" that, as to other types of stays, such as that involved here, the burden is on the party seeking a modification or the lifting of the stay.

by the Supreme Court in Foust v. Munson Steamship Lines, 299 U.S. 77 (1936), as follows:

"The Court is to exercise the power conferred by subd. (c) (10) [of Section 77B] according to the particular circumstances of the case and is to be guided by considerations that under the law make for the ascertainment of what is just to the claimants, the debtor and the estate. Osborn v. U.S. Bank, 9 Wheat. 738, 866. The Styria v. Morgan, 186 U.S. 1, 9. Langnes v. Green, 282 U.S. 531, 541. Burns v. United States, 287 U.S. 216, 222-223. (299 U.S. at p. 83; emphasis added)

Later in the Foust decision, the Court alluded to a desire not to "encumber the reorganization proceedings" (299 U.S. at 86) and to proceed in a manner which would not "hinder, burden, delay or be at all inconsistent with the pending corporate reorganization proceeding." (299 U.S. at 87-88).

In In Re Laufer, 230 F. 2d 866 (2d Cir. 1956), Judge Medina, citing Foust v. Munson, supra, and In Re Adolf Gobel, Inc., 99 F. 2d 171 (2d Cir. 1937), reversed the denial of a petition to lift a stay of suits, stating:

"... the facts here would not support a finding that granting petitioner such permission would have imposed any undue disadvantage on the debtor or have hindered, burdened or been otherwise inconsistent with the arrangement proceeding.

* * *

"...the question below should have been whether the state court proceeding would embarrass or delay the administration of the estate of the debtor. 230 F. 2d at p. 868.

The evidence adduced by the Trustees on the issue of prejudice, evidence which was uncontradicted, is discussed at pages 12-14, supra, and will not be repeated here. Suffice it to say that no evidence whatever was presented by Esgro on the question of prejudice. At best, Esgro attempted at the May 21, 1971 trial before the Bankruptcy Judge to demonstrate that California might be a more convenient forum--for Esgro but not for the Trustees--in which to try the Esgro claim and that some but not all of the potential witnesses reside in California.*

In every case we have seen where a stay of suits was lifted, it was demonstrated to the Court's satisfaction that a substantial right of the claimant would be prejudiced if the stay was continued. For example, the decision in Foust v. Munson, supra, was clearly predicated upon the express finding that, if the petitioner's claim was adjudicated in the bankruptcy court rather than the New York Supreme Court, a "grave doubt will arise as to the liability of the [debtor's] insurer to petitioner" under the Insurance Law of the State of New York. (299 U.S. at p. 87) Precisely the same considerations were involved in this Court's decision in In Re Adolf Gobel, Inc., supra.

*See pages 33-36, infra, which discuss the "findings" in this regard as contained in Judge Ryan's July 26, 1976 Order.

In In Re Zeckendorf, 326 F. Supp. 182 (S.D.N.Y. 1971), Judge Frankel, in reversing Referee Herzog's refusal to lift a stay, was careful to point out the prejudice inherent in a situation where a plaintiff, in a multi-defendant securities fraud action, is not permitted to at least depose the debtor, the central participant in the alleged fraud. Also in Zeckendorf, the debtor had participated in the action, despite the pendency of the Chapter XI proceeding, for two years and only sought to hide behind the protection of the stay when the plaintiff noticed his deposition. Also, unlike here, it appears that the Zeckendorf arrangement proceeding had been pending for quite some time "with no sign of imminent success" (326 F. Supp. at p. 184)

Similarly, in In Re Laufer, supra, Judge Medina was careful to note that the "disadvantage to the petitioner is obvious", pointing out that unless the state court action was permitted to continue, the petitioner would be powerless to prevent further fair trade violations once the Chapter XI proceedings was terminated.

Also, it is important to note that in each of the above discussed cases, the attempt to lift or modify the stay was initiated by the claimant. None of those cases involved a situation where the debtor was pressing for a quick adjudication of the claim. Here, Esagro made no

move to lift the stay so as to permit it to prosecute its \$38,000,000 claim until pressed to do so by the Trustees' filing of an application to expunge the claim. It was only when it was faced with the prospect of a speedy adjudication of its claim in the Bankruptcy Court* that Esgro decided its claim was worth pursuing in the California Court.

Esgro has made much of the fact that if its claim is not tried as part of the California Proceeding, it will be deprived of its right to a jury trial. The answer to this is, of course, that there is no right to a jury trial on a claim filed in a bankruptcy proceeding. Katchen v. Landy, 382 U.S. 323 (1966). The Court in Foust v. Munson, a case which involved but did not turn upon the petitioner's right to a jury trial, noted that "[t]he reorganization proceedings were not inherently inconsistent with jury trial for the liquidation of such claims" (299 U.S. 84).** Indeed, if

* At page 30 of its brief, Appellant complains that its claim will be "summarily tried" before the District Judge who according to appellant is not an "independent court". There will, of course, be no such "summary" determination. The trustees' objection to the Esgro claim will be the subject of a full trial on the merits at which time Esgro will be given the opportunity to present all of the evidence it can muster in support of its claim.

** At page 21 of its brief, Appellant quotes a portion of the Foust decision in an attempt to demonstrate "[t]he importance of preserving the right to trial by jury" (Appellant's Brief, p. 20). However, the quoted language was employed by the Court in Foust not in connection with any holding that the petitioner was entitled to a trial by jury - for there was no such holding - but rather in criticizing the Circuit Court's statement which questioned whether a jury would return an appropriate verdict.

the right to a jury trial could act to divest a bankruptcy court of the power to adjudicate claims, many claims, routinely handled by bankruptcy courts, such as claims for goods sold and delivered, could not be heard.

In In Re Michigan Brewing Co., 24 F. Supp. 430 (W.D. Mich. 1938), aff'd. 101 F.2d 1007 (6th Cir. 1939), the Court answered a claim of prejudice by reason of the denial of a jury trial as follows:

"The only rights of which petitioner will be deprived by denial of his petition are the right to trial by jury and the opportunity to try the cases against the four defendants in one forum and at the same time. ... It must be observed that the bankruptcy court which acts as a court of equity ordinarily exercises exclusive control over all issues involved and that claims for debt or damages against bankrupt are ordinarily investigated by chancery methods wherein the principle is applied that the right of trial by jury considered as an absolute right does not extend to cases of equity jurisdiction." (24 F. Supp. at 431; emphasis added)

The Michigan Brewing case presented issues strikingly similar to those presented here. There the petitioner, prior to the filing of the debtor's petition for reorganization, had commenced an action in the state court alleging violations of the antifraud provision of the Michigan Blue Sky Laws. Like here, the claim involved was disproportionately large in relation to the total claims. The Court first noted that the cases relied upon by the claimant (Foust v. Munson and In Re Adolf Gobel, Inc., supra) involved facts

where it was apparent that the petitioners there would be denied substantial rights if leave to proceed in the state court were not granted. The Court, however, found no such substantial rights being prejudiced in the case before it. Rather, it stated that:

"... it appears to the court that to deny a stay of the pending proceedings in the state court would amount in substance to a denial of the right of the corporation, its stockholders and other creditors to the benefits of the provisions of section 77B of the Bankruptcy Act. ... It is difficult to see how any plan of reorganization could be properly considered until after Conlon's claim is adjudicated. It is clearly a case in which adjudication of petitioner's claim must be accomplished with all due speed to avoid long postponement of action upon plans for reorganization. A denial of the pending petition will enable petitioner's claim to be promptly adjudicated under the direction and control of this court. Action in the state court might be long delayed by action or non-action of other defendants." (24 F. Supp. at pp. 430-31; emphasis added)

The above could well have been written about the situation presented here. Everyone involved in the reorganization, except Esgro, is in the position of being substantially prejudiced by the Bankruptcy Judge's refusal to direct an immediate trial of the Trustees' objection to the Esgro claim. The debtors are denied the right to formulate a feasible plan at the earliest possible time and, assuming the estate is ultimately found to be solvent, are thus being forced to incur substantial interest charges each month the Esgro claim remains undecided. For

the same reasons, the creditors of the estate are being seriously prejudiced. And, clearly the shareholders are being prejudiced in that the claim upon which solvency, and thus their right to participate in the reorganization, turns is being placed "under the direction and control" of the California Superior Court.

Moreover, the Securities and Exchange Commission, which by statute is charged with the responsibility of representing the public shareholders of the debtors, does not even have standing to participate in the California Proceeding even though, in the final analysis, it would appear that it is the public shareholders who have the most at stake.

Appellant, at page 22 of its brief, cites In Re Wonderbowl, Inc. 456 F.2d 954 (9th Cir. 1972) as a "strikingly similar case". However, an examination of the facts of that case, which are not at all discussed by Appellant, demonstrates that it is entirely inapposite. Thus, the trustee initially sought a determination in the Bankruptcy Court of the debtor's interest in four separate properties. The trustee's application, which initially named fifteen respondents and alleged a fraudulent scheme to deprive the debtor of the property, was limited, as a result of jurisdictional objections, to three properties and only three respondents. Thereupon the trustee commenced plenary actions

where it joined all parties allegedly involved in the scheme and sought relief as to all four properties. In view of the jurisdictional limitations imposed by the Bankruptcy Court, the trustee obviously could not get complete relief in that court on its claim. No matter what happened in the Bankruptcy Court the same claim would have to be again adjudicated in the plenary action. That is not the situation presented here. Esqro can get complete relief on its claim in the Bankruptcy Court. Once adjudicated it will not have to be relitigated in the California proceeding. Also, it is significant that in the Wonderbowl case, the court concluded that the trustee's argument with respect to the need for a speedy adjudication "has lost its force" due to changed circumstances (456 F.2d at p. 956).

Appellant complains, at page 28 of its brief, that the District Court "ignored the findings of fact made by the Bankruptcy Court in the Order of July 23, 1976" - findings which, as previously noted, were drafted by counsel for Esqro and adopted by the Bankruptcy Judge in toto - and argues that said findings cannot be set aside unless "clearly erroneous". An examination of the record shows, however, that the findings relied upon by appellant were "clearly erroneous".

The first "finding" pointed to by appellant is finding number 8 contained in the July 23, order which stated:

"8. No prejudice, harm or disability is incurred by the Reorganization Trustees and the

reorganization cases by modification of the automatic stay under Chapter X Rule 10-601 so as to allow the prosecution and trial of the California Action." (A485)

This "finding" completely ignored the uncontradicted evidence of prejudice which was presented by the Trustees at the May 21 trial. This evidence, which is discussed in detail at pages 12-14, supra to which the court is respectfully referred, clearly supports Judge Cannella's conclusion that "[e]ven a minor delay at this juncture would place an undue burden on these reorganization proceedings" (A504).

The other "finding" relied upon by appellant is finding No. 9 which stated:

"9. The prosecution and trial of the California Action as authorized by the Court* is in the interests of justice and convenience of the parties and potential witnesses." (A485)

When viewed in its entirety, the evidence presented at the May 21 trial shows that the "convenience of the parties and potential witnesses" requires that the trial be held in New York. Although California counsel for Esqro at first indicated that he would have to call "a minimum of ten witnesses"

* No prior order of the Bankruptcy Judge had "authorized" the "trial of the California Action". The May 26 order modified the stay of suits only in two limited respects. For this reason alone Finding No. 9, as well as Finding No 8 which refers to the "prosecution and trial of the California Action", is clearly erroneous.

(A117) and referred generally to witnesses residing in California (A119-20), he could identify by name only four potential witnesses* (A118-19). Three were said to be present employees of Esgro (A118) who, of course, could be "compelled" to come to New York. The fourth was Harry Epstein who was formerly employed by the debtors and whose deposition had already been noticed by the Trustees at the time of the May 21 trial.**

On cross examination Esgro's counsel conceded that the testimony of at least two other individuals, both of whom reside in New York, would be relevant on one of the principal issues involved in the Esgro claim (A197). Another key witness, a former officer of White Front was also identified as residing in the New York area (A152, A230). In addition, the Trustees' California counsel testified that it would be "inconvenient ... to a fairly significant extent" to have to try the Esgro claim in California since the documentation is in New York (A151) and most of the witnesses he envisioned would have to be called were located in New York (A227-31).

* Esgro's counsel also referred generally to calling witnesses having firsthand knowledge of the operation of the 33 White Front stores in question (A119) and persons affiliated with Esgro's independent accounting firm (A120). No attempt has been made to date to depose any of these "witnesses" and no specific reference was made to such witnesses when Esgro argued, in support of its motion for a stay of the September 1, 1976 order, to both this Court and to the District Court that additional discovery was needed (A514).

** This deposition as well as the deposition of a former Esgro employee were conducted in California in July. Esgro, on the other hand, when it finally got around to noticing the deposition of three California witnesses for September, decided to cancel two of these depositions.

Thus, it would appear that the only portion of the above finding which is not clearly erroneous is that a California trial would be more convenient to Esaro. The evidence discussed above can leave no doubt that such a trial would not be convenient for the Trustees, their counsel or most potential witnesses. Moreover, in view of the uncontradicted evidence of prejudice discussed above, the finding is clearly erroneous to the extent it refers to the "interests of justice".

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that, should the Court determine that it has jurisdiction to hear this appeal, the September 1, 1976 order of the District Court should be affirmed in all respects.

Respectfully submitted,

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APPENDIX TO BRIEF
OF APPELLES

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- - - - -X Reorganization Nos.
In Re : 74 B 614-802
Inclusive
INTERSTATE STORES, INC., formerly :
known as INTERSTATE DEPARTMENT : Docket No. 76-5034
STORES, INC., et al., :
Debtors. :
- - - - -X

MEMORANDUM OF LAW IN SUPPORT
OF MOTION TO DISMISS APPEAL

Preliminary Statement

This memorandum is submitted on behalf of the Trustees of the above captioned debtors in support of their motion to dismiss the appeal of Irving Sulmeyer, the Chapter XI Receiver of the Estate of Esgro, Inc. ("Esgro"), one of the claimants in this reorganization proceeding, from a decision and order of the Honorable John M. Cannella, United States District Judge, dated September 1, 1976. The basis for the instant motion is that said September 1 order merely vacated the District Court's reference to the Bankruptcy Judge of the reorganization proceeding as it related to the Esgro claim and set a trial date for the adjudication of the Trustees' objection to that claim and, therefore, is not appealable under Section 24 of the Bankruptcy Act.

The Facts

On May 22, 1974, the captioned debtors filed petitions under Chapter XI §322 of the Bankruptcy Act and, thereafter, on June 13, 1974, an amended petition for reorganization pursuant to the provisions of Chapter X of the Bankruptcy Act was filed. Said amended petition was thereafter approved by order dated June 13, 1974. Pursuant to said order, Joseph R. Crowley and Herbert B. Siegel were appointed, have qualified and are now acting as the Trustees of the captioned debtors, including the debtors formerly engaged in operating the White Front Discount Department Stores (the "White Front debtors").

On August 29, 1974, Esgro, Inc. filed a claim (No. 7273A) with the Trustees. This claim was for over \$38,000,000 and was by far the largest single claim filed in this proceeding.

On August 14, 1975, the District Court entered an order pursuant to Rule 10-103 of the Chapter X Rules referring all matters arising in this proceeding to the Honorable Edward J. Ryan, Bankruptcy Judge.* That order expressly reserved "the right and jurisdiction to make, from time to time, and at any time, such orders amplifying, extending, limiting or otherwise modifying" the order of reference as the Court deemed just and proper. (See Shelton Supp. Aff., Ex. C)

On April 9, 1976, the Trustees filed an objection to the Esgro claim. Concurrently with the filing of the objection, discovery proceedings were instituted by the service of Interrogatories, a Notice to Admit and a deposition notice.

*The August 14, 1975 order superseded a prior order of reference dated June 18, 1974, as amended on July 1, 1974. See Exhibits A and B to Supplemental Affidavit of Martin I. Shelton, sworn to September 26, 1976 ("Shelton Supp. Aff.")

Shortly thereafter, additional deposition notices were served.

On May 10, 1976, Esgro, through its Chapter XI Receiver Sulmeyer, served and filed a complaint under Section 10-601* of the Bankruptcy Act seeking, inter alia, dismissal of the Trustees' objection to its claim and the modification of the June 13, 1974 stay of suits, entered in this proceeding under Section 10-601 of the Bankruptcy Act, so as to permit the prosecution "to judgment" of Esgro's cross-complaint then pending in an action in the California Superior Court. The background of this cross-complaint is as follows:

Esgro had been a licensee operating several license departments in stores operated by the White Front debtors. In February of 1973, the White Front debtors had filed a complaint in the California Superior Court (the "California proceeding") seeking to recover amounts due from Esgro in respect of rent and other items totalling over \$879,000. In July of 1973, Esgro had interposed a cross-complaint in the California proceeding seeking damages of \$35,000,000 by reason of said debtors' alleged breach of contract and fraud. Claim No. 7273A of Esgro

* See Exhibit A to the affidavit of Martin I. Shelton, sworn to September 24, 1976 ("Shelton Aff.") and submitted in support of the instant motion.

in this proceeding contained the same allegations of wrongdoing as those contained in the cross-complaint in the California proceeding.

Bankruptcy Judge Ryan set down the trial of Esgro's Complaint under Section 10-601 for May 21, 1976. After the trial, at which the Trustees presented uncontradicted evidence that a meaningful plan of reorganization could not be formulated until the Esgro claim was adjudicated, Judge Ryan entered an order dated May 26, 1976 (Shelton Aff. Ex. B) in which he modified the stay of suits so as to:

(a) direct the parties "to make an appropriate application to the Superior Court of the State of California, County of Los Angeles, seeking an order advancing the trial date so as to obtain the earliest possible trial of the California Proceedings;" and

(b) direct that "all discovery and other pre-trial proceedings in both the proceedings instituted by the Trustees on their application to expunge Claim 7273A of Esgro, Inc. ... to the extent heretofore noticed or served and in the California Proceedings be conducted and completed on an expedited basis", directing that any such discovery that was conducted could be used in either proceeding.

The May 26, 1976 order further directed the parties to report back to the Bankruptcy Judge on or before July 8, 1976 in order to advise the Court as to the progress of

discovery and the results of their application to the California Superior Court. The order then went on to provide that:

"except to the extent otherwise indicated herein, the relief requested in the complaint herein be and the same hereby is denied in all respects."

Thus, the Bankruptcy Judge refused to dismiss the Trustees' objection to the Esgro claim, as requested in the \$10-601 complaint and did not vacate the stay of suits as it related to Esgro so as to permit the "prosecution to judgment" by Esgro of its cross-complaint in the California proceedings. Rather, the stay of suits was merely modified so as to permit an application for an early trial to be made to the California court and so as to permit discovery to proceed.

No appeal was taken by either party from Judge Ryan's May 26, 1976 order.

Shortly after the entry of the May 26, 1976 order, the Trustees made an application to Judge Ryan for an order striking Esgro's claim on the ground that Esgro had failed to appear for the deposition previously noticed. That application was denied "without prejudice" by order dated June 16, 1976 (Shelton Aff. Ex. C). That order also

directed that all discovery "be conducted under the auspices and control of the California Court."

No appeal was taken from the June 16, 1976 order. It is important to note that up to this point in time the stay of suits as it related to Esgro had not been vacated and the Trustees' objection to Esgro's claim was still pending before the Bankruptcy Court. The Bankruptcy Judge had, in effect, merely declined to set a date for the adjudication of said objection.

The application by the Receiver to the California Superior Court resulted in that Court setting the California proceeding down for trial on November 29, 1976. Taking the position that said date was tentative and, based upon what has happened in the recent past in the California Court, that said trial date could well be adjourned for a considerable period after November 29, the Trustees applied to Judge Ryan for an order setting their objection to Esgro's claim down for trial on September 15, 1976 or as soon thereafter as the Court's calendar permitted. A copy of the Trustees' application in this regard is annexed to the Shelton Aff. as Ex. D. This application was denied with prejudice by the Bankruptcy Court by order dated July 23, 1976. (Shelton Aff. Ex. E) That order also contained purported findings - although the

only application before the Court was that of the Trustees for a September 15 trial date. One of these findings stated that the "prosecution and trial of the California action as authorized by the Court is in the interests of justice and convenience of the parties and potential witnesses." (Emphasis added.) This "finding" was made despite the fact that, as noted above, at no time had any order of the Bankruptcy Court "authorized" the "prosecution and trial of the California action." Indeed, such a direction was not even contained in the July 23 order, the sole decretal paragraph of said order merely directing that the Trustees' application "be denied in all respects with prejudice."

The Trustees took a timely appeal to the District Judge from the July 23 order and on September 1, 1976 Judge Cannella entered a decision and order setting aside the July 23 order of the Bankruptcy Judge vacating the Court's reference of these proceedings to Judge Ryan with respect to the Esgro claim and directing that the trial of the Trustees' objection to the Esgro claim commence on October 18, 1976. (Shelton Aff. Ex. F) Judge Cannella found that the Bankruptcy Judge had abused his discretion and that "[e]ven a minor delay at this juncture would place an undue burden on these reorganization proceedings." It is from that order that Esgro now seeks to appeal.

Argument

THE APPEAL MUST BE DISMISSED
IN THAT THE SEPTEMBER 1, 1976
ORDER IS NOT APPEALABLE UNDER
SECTION 24 OF THE BANKRUPTCY
ACT

This Court's jurisdiction to hear this appeal is governed by §24(a) of the Bankruptcy Act (11 U.S.C. §47) which provides in relevant part:

"The United States court of appeals, ... are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact ..."

As can be seen, Section 24(a) distinguishes between "proceedings in bankruptcy" - where either interlocutory or final orders are appealable - and "controversies arising in proceedings in bankruptcy" where only final orders are appealable.

There can be no question but that the instant order is interlocutory in nature. Therefore, if we are concerned here with a "controversy arising in a proceeding in bankruptcy", as opposed to a "proceeding in bankruptcy", the order is clearly not appealable. The distinction between

"proceedings" and "controversies" is anything but clear. In United Kingdom Mutual Steamship Assur. Ass'n. v. Liman, 418 F.2d 9 (2d Cir. 1969), this Court made the "hairline thin" distinction between a "proceeding" and a "controversy" by referring to Judge Lumbard's decision in Pettit v. Olean Industries, Inc., 266 F.2d 833 (2d Cir. 1959), stating that a proceeding contains a controversy if the matter involves a claimant who "raises a dispute with regard to the propriety of including property in the estate for distribution, rather than a question with regard to the administration of the estate once it is amassed." 418 F.2d at p. 10 Or, as the Court stated in Hillcrest Lumber Co., Inc. v. Terminal Factors, Inc., 281 F.2d 323, 325 (2d Cir. 1960):

"Proceedings in bankruptcy have been defined as 'those matters of an administrative character, including questions between the bankrupt and his creditors, which are presented in the ordinary course of the administration of the bankrupt's estate.' 2 Collier, Bankruptcy ¶24.12 and cases there cited (14th Ed. 1956). Controversies arising in proceedings in bankruptcy 'embrace those matters arising in the course of a bankruptcy proceeding which are not mere steps in the administration of the estate, but which give rise to distinct and separable issues between the trustees and adverse claimants, concerning the right and title to the bankrupt's estate.' 2 Collier, Bankruptcy ¶24.28 and cases there cited (14th Ed. 1956)."

Applying the above stated test, it would appear that we are dealing here not with a "controversy" but, rather with a "proceeding." Therefore, as a general rule, interlocutory orders are appealable under Section 24(a) of the Bankruptcy Act. The inquiry, however, does not stop there. Courts have consistently interpreted Section 24(a) so as to allow an appeal from interlocutory orders only when the order involved disposes of some right or duty asserted by one of the parties. Sherr v. Sierra Trading Corp., 492 F. 2d 971, 975 (10 Cir. 1974); In Re Charmar Investment Co., 475 F. 2d 560, 563 (6 Cir. 1973), cert. denied 414 U.S. 823 (1973); Cope v. Aetna Finance Co., 412 F. 2d 635, 639 (1 Cir. 1969); Carolina Mills v. Corry, 206 F. 2d 76, 77 (4 Cir. 1953); In re Chicago Rapid Transit Co., 200 F. 2d 341, 342 (7 Cir. 1953); City of Fort Lauderdale v. Freeman, 197 F. 2d 122, 124 (5 Cir. 1952).

The reason for this rule was graphically stated by the court In Re Durensky, 519 F. 2d 1024, 1028 (5 Cir. 1975), as follows:

"The obvious explanation for this judicial gloss on the statutory language is that if every word issuing from the bankruptcy judge's mouth or pen were to be a proper subject for immediate review by the district court and the court of appeals, bankruptcy proceedings would cease to offer a reasonably swift resolution of pressing economic difficulties."

In Re Durensky involved an attempted appeal by the government from an order of the district court remanding a case to the bankruptcy judge for a hearing on the merits. As noted, here, the District Court, rather than remanding the case to the district court, vacated the order of reference as it related to the Esagro claim and directed that the trial proceed before it rather than the Bankruptcy Judge.

The "judicial gloss on the statutory language" of Section 24(a) has long been recognized in this Circuit. See Dubnoff v. Goldstein, 385 F. 2d 717, 722 (2d Cir. 1967); Dutch American Mercantile Corp. v. Eighteenth Avenue Land Co., 302 F. 2d 636, 637 (2d Cir. 1962), cert. denied 379 U.S. 834 (1964); Lesser v. Migden, 328 F. 2d 47, 48 (2d Cir. 1964); Hillcrest Lumber Co. v. Terminal Factors, Inc., 281 F. 2d 323, 325 (2d Cir. 1960); In re Hotel Governor Clinton, 107 F. 2d 398, 399 (2d Cir. 1939).

In Dutch American Mercantile Corp. v. Eighteenth Avenue Land Co., supra, the Court did not even concern itself with the question of whether the case involved a "proceeding" or "controversy", holding merely that the interlocutory order appealed from was not appealable in any event. There, review was sought from an order which reversed the order of the referee and remanded the matter to him for further proceedings. The Court stated:

"The order sought to be reviewed here did not determine with finality any substantive issue in dispute between the parties. It directed merely that further evidence be taken on the issues. Whether a 'proceeding' or a 'controversy' is involved, we do not believe the order is appealable." 302 F. 2d at 637.

In Lesser v. Migden, supra, the trustee had appealed from an order of the District Judge which had reversed a referee's order expunging a portion of a claim and remanded to the referee. The Court, citing 2 Collier on Bankruptcy 792 (14th Ed. 1962) stated:

"However, not every interlocutory order entered in a 'proceeding in bankruptcy' is automatically appealable. The order must dispose of some asserted right, and an order which is not 'a formal exercise of judicial power affecting the asserted rights of a party' is not appealable." 328 F. 2d at 48 (Emphasis added.)

In In re Berthood, 238 F. 797 (2d Cir. 1916), the Court held that the case before it "presented ... nothing for judicial action" in that the order appealed from "does no more than direct a trial of the issues."

In the instant case, it is, we respectfully submit, clear that Judge Cannella's order did not dispose of any asserted right of the parties. It was strictly procedural in nature and merely set the Trustees' objection to Esgro's claim down for trial on a date certain. In General Electric

Co. v. Beehive Telecasting Corp., 284 F. 2d 507, 509 (10 Cir. 1960), the Court stated:

"It must necessarily lie within the administrative province of the trial court to continue or postpone for any reasonable period a hearing on a matter arising in the course of the bankruptcy proceedings to suit the convenience of the parties or the court. Any appellate interference with the exercise of this administrative function is, to be sure, unwarranted in the absence of a showing of clear abuse."

If it is within the "administrative province" of the trial court to regulate its calendar without "appellate interference" by continuing or postponing a hearing on a matter arising in the course of a bankruptcy proceeding, then, we submit, it is similarly within the "administrative province" of the court to direct a hearing of such a matter.

A further indication of the non-appealability of the order involved here is the fact that in non-bankruptcy matters, it is routinely held that orders relating to the manner in which a matter shall be tried do not involve a "controlling question of law" so as to warrant appellate review of such orders under 28 U.S.C. §1292. See Leighton v. New York Susquehanna and Western R. Co., 306 F. Supp. 513 (S.D.N.Y. 1969) and Schine v. Schine, 367 F. 2d 685 (2d Cir. 1966) and cases cited therein at p. 688. And it has long been the rule that an appeal will not be from an

interlocutory order relating "to mere preliminary or procedural matters" since such preliminary or procedural matters can be considered on any appeal taken after a determination of the merits. Carolina Mills v. Corry, 206 F. 2d 76, 77 (4 Cir. 1953). See also In re Horowitz, 250 F. 106 (2d Cir. 1918) and In re Strauss, 211 F. 123 (2d Cir. 1914).

CONCLUSION

For all of the foregoing reasons, the order appealed from is non-appealable and the appeal should, therefore, be dismissed.

Dated: New York, New York
September 24, 1976

Respectfully submitted,

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United States Court of Appeals
for the Second Circuit

In re Interstate Stores, Inc., formerly known as
Interstate Department Stores, Inc., et al.,

Debtors-Appelles.

**AFFIDAVIT
OF SERVICE**

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss.:

Wesley Mc Daniel, being duly sworn, deposes and says that he
is over the age of 18 years, is not a party to the action, and resides
at 2189 Pitkin avenue, Brooklyn, New York
That on , he served 2 copies of

Appellees Brief
on

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New York, New York.

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26 Federal Plaza,
New York, New York.

Zalkin Rodin & Goodman
750 Third Avenue
New York, New York

by delivering to and leaving same with a proper person or persons in
charge of the office or offices at the above address or addresses during
the usual business hours of said day.

... Wesley McDaniel ...

Sworn to before me this
1st day of October, 1976

John V. D'Esposito
JOHN V. D'ESPOSITO
Notary Public, State of New York
No. 30 0932350
Qualified in Nassau County
Commission Expires March 30, 1977